

**MODERNIZING FINANCIAL  
MANAGEMENT FOR HUNGARIAN  
LOCAL GOVERNMENTS**

**PILOT YEAR SEMINAR  
OCTOBER 30 - 31, 1996**

Prepared by

Ritu Nayyar-Stone

The Urban Institute  
2100 M Street, NW  
Washington, DC 20037

UI Project 06610-530  
November 1996

Prepared for

East European Regional Housing Sector Assistance Project  
Project 180-0034

U.S. Agency for International Development, ENI/EEUD/UDH  
Contract No. EPE-0034-C-00-5110-00, RFS No. 530



## TABLE OF CONTENTS

### MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTSPILLOT YEAR, OCTOBER 30 - 31, 1996

I.	October 30, 1996 .....	1
	A. Training Session I .....	2
	B. Training Session II .....	3
II.	October 31, 1996 .....	5
	A. Training Session I .....	7
	B. Guest Speaker .....	8
	C. Training Session II .....	8
III.	Background Reading .....	9
IV.	Local Government Homework .....	9
V.	Conclusions .....	9







## **MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTS PILOT YEAR, OCTOBER 30 - 31, 1996**

This report is a brief description of the October seminar on modernizing financial management for Hungarian local governments. The program aims at providing financial officers of Hungarian local governments with skills and information to help them improve budgeting and financial management within their cities. The October seminar was the third of six seminars which will be held throughout the Hungarian local budget cycle from June 1996 - March 1997.

The two day seminar was held on October 30 - 31, 1996 at Hotel Rubin in Budapest. The course material handed out to participants, the agenda, and a list of participants are included in Annex A. Eleven local governments attended the October seminar. Table 1 shows the list of local governments who have attended the three seminars held this far. The participating local governments represent a wide range of size and location, ranging from large cities such as Győr and Pécs and two districts from Budapest to the smaller towns of Püspökladány and Orosháza.

### **I. October 30, 1996**

The program started with an introduction and follow up of the last meeting by Mr. József Hegedüs from the Metropolitan Research Institute (MRI). Mr. Hegedüs briefly mentioned the topics covered by the previous seminars and stated the skill areas which would be presented at the present workshop. He outlined the sequence of presentations and stated that topics covered in the first day of the seminar had been prepared such that they were specifically applicable to the housing and communal services program areas. This was deliberately done so that all examples would be practical and non-abstract.

Following the introduction, Mr. Philip Rosenberg (consultant to the Urban Institute) did a follow up from the last meeting. He requested the participants to think about the following questions, and asked each local government representative to talk briefly the following day about: where they were in the budget process, what they were doing differently in the budget due to their participation in the seminar, and, what were their successes and failures. He reminded the participants that the program enabled field trips and visits and that a trip was being made to the city of Debrecen to meet with the city council to explain the importance and applicability of this program to the city, and to reinforce their commitment to the process of bringing about change in their budgetary practice. If any other city needed a similar or technical visit, they should inform MRI. Mr. Rosenberg also reminded the participants about their role in the budgetary process— either as advisors, facilitators or implementors—, and their customers being the mayor, office of the mayor, department heads, institutions and of course citizens of the community.

Ms. Andrea Tönk\_ and Ms. Judit Kalmán of MRI followed Mr. Rosenberg's presentation by providing a comprehensive background on the structure of housing and communal service programs at the municipal level respectively. They outlined the functions of local governments, tools available to the local government in implementing the programs, possible alternative sub-programs and the revenue sources and possible expenditures in these two program areas.

Ms. Katalin Pallai (Hungarian local trainer) did a review of the homework submitted by local governments since the last seminar in September. Municipalities had been asked to develop a municipal policy for their city, goals and objectives, and priority programs and sub-programs. The homework revealed that participants were confused about the link and distinction between the goal of a municipal policy and goals and objectives of programs and sub-programs. Ms. Pallai structured her presentation to clarify this point, and used the homework of three local governments—Kispest, Jászladány and Gy\_r to illustrate the distinction.

### **A. Training Session I**

After Ms. Pallai's presentation, Mr. Blue Wooldridge (consultant to the Urban Institute) revisited the topic of budget reform, steps in developing a program budget and search for possible solutions to achieve program objectives which had been discussed in the September workshop. He also briefly discussed the difference between strategic goals and strategic program objectives to complement Ms. Pallai's presentation. After Mr. Wooldridge's presentation, the participants did an exercise on writing strategic objectives and possible solutions. Two groups were formed, one using housing as the focus of the exercise, while the other used communal services. Results of the exercise are as follows:

#### ***Housing Group:***

Program: Housing Construction and mobility

Strategic Goal: A new housing goal which includes plot preparation, increasing the number of floors to existing housing, and financial assistance to the housing sector.

Strategic Objective: A 30 percent yearly increase by the year 2000 in new construction. For every 100 units of new and existing housing units, 300 individuals would be housed (become mobile).

Criteria used in selecting the solution:

- n How much central grant is available for the housing sector and for what purpose.
- n Volume of municipal finances available (housing fund)
- n Paying/burden bearing ability of the residents.
- n Construction cost
- n Preference of the tax system



Proposed solution: New construction

***Waste Management Group:***

Program: Solid Waste

General Goal: Create a clean environment

Strategy: Professional and safe method of collection and treatment of waste in the community.

Alternatives:

- n Selective or bulk collection
- n Technological change
  - Collection and treatment by one or several organizations
  - Local or regional level
  - Landfill or incinerator

Criteria:

- n Forecast of volume
- n Modernization of investment
- n Efficiency
- n Long term solution
- n Possibility to intervene/impact
- n Comply with professional standards

**B. Training Session II**

The second training session was in the area of performance measurement (PM). Mr. Blue Wooldridge started with a theoretical background on performance measurement and Ms. Ritu Nayyar-Stone (the Urban Institute (UI)) presented the application of performance measurement to the programs of housing and communal services. Mr. Wooldridge defined PM and explained the uses of PM data. He also stated the different PM indicators frequently used and the criteria for selecting a final set of measures. He ended his presentation by outlining the steps in establishing a PM system.

Ms. Nayyar-Stone focused her presentation on the housing and communal services program. Performance measurement indicators were developed for the following sub-programs: housing allowance, land servicing, solid waste collection, solid waste disposal and street cleaning. Due to lack of time, slides were presented only for the housing allowance and solid waste disposal sub-programs. Ms. Nayyar-Stone started by defining a strategic goal for the broad program area and a more specific strategic program objective. She then presented a cause and effect logic diagram which would help quantify a program's intermediate and end outcomes and also lead to an identification of input, output, outcome and efficiency performance measures. Finally, detailed performance measures were

developed in the 4 categories above and she concluded with the sources of data available to a finance officer in developing PM techniques.

Following the two presentations, participants were again divided into two groups dealing with housing and communal services respectively and PM indicators were developed for two sub-programs associated with the above programs.

### ***Housing Group:***

Goal: To ensure convenient, modern and affordable housing

Sub-Program: Housing construction (subsidize private construction per year)

Strategic Objective:

n To build 300 housing units by year 2000, of which 200 will be private and 100 social housing. Of the 100 social housing units, 20 will be for an elderly population, 25 for students, 30 for social and 25 rehabilitated units.

Input performance measures:

- n Cost of municipal investment in housing
- n Volume of subsidies for private construction
- n Central assistance
- n Administrative cost

Output performance measures:

- n Number of new units built
- n Increase in mobility

Outcome measures:

- n Decrease in the number of households needing assistance
- n Decrease in the number of households waiting for a flat

Efficiency Measures:

- n Cost per square meter
- n Cost per transaction
- n Central subsidy for 1 HUF of municipal cost

Other explanatory information:

- n Demographic changes
- n Location
- n Price of existing housing

Sources of data:

- n Housing department
- n Housing stock
- n Central statistical office
- n Real estate agency

### ***Waste Management Group:***

Goal: To contribute to a healthy drinking water and environment of the city.

Objective:

- n Increase the households joined to the sewage by 10 percent by 1998
- n By 1999 build a treatment plant for liquid sewage which will have a 1000 cubic meter capacity per day.
- n Decrease in illness caused by contaminated water by 1999.

Input Performance Measures:

- n Cost of sewage construction and liquid plant construction
- n Vehicles
- n Personnel
- n Capacity

Output Performance Measures:

- n Number of customers (households) served
- n Total volume of treated sewage
- n Length of new pipelines
- n Volume of liquid sewage

Efficiency Measures:

- n Cost per number of households served per 1 meter of sewage pipe
- n Cost per 1 meter of pipe
- n Cost of collection per 1 meter of waste
- n Volume of sewage waste per capita

Explanatory information:

- n Capacity of the treatment plant

Following the training sessions, Mr Philip Rosenberg (consultant to UI) and Mr. Péter László (city government of Szolnok) made a presentation on Implementing Program Budgeting in Your Municipality. Since Szolnok is the first city in Hungary to implement and incorporate program budgeting in their 1996 budget, other cities are very keen to hear about Szolnoks' experience in this endeavor.

Mr. László talked about the procedure adopted by Szolnok in incorporating program budgeting. The key motivating factor was that budgeting was in a state of crisis, due to limitations in revenue collections and expenditure possibilities. One solution was to bring about change in the attitude and process of budgeting. The technique employed was to focus on strategic planning and organization of programs which would help in the decision making process, rather than on expenditure and revenues. A schedule was made for the next three years to: 1) involve city hall in program budgeting; 2) expand program budgeting to the institutions; and, 3) coordinate all the activity together. Eight programs were defined for city hall in 1996, and they had to compete for funds. It was important to obtain commitment for this process from all the players which required several meetings and brainstorming sessions. The result was that new information was included in the budget—to

make it more accessible and readable by the layman and citizens. New computers and software was also bought to facilitate change in the budget manual.

## **II. October 31, 1996**

The seminar started at 9.00 a.m. on the second day, with Mr. Rosenberg reviewing the forecasting homework submitted by the local governments. Mr. Rosenberg commented that in general he was pleased with the forecasting ability of the local governments since their revenue and expenditure estimates were quite close to actual or realized values. However, some local governments seemed to follow an ad hoc policy of infrastructure investment, by diverting revenue estimates/allocations for infrastructure investments into other categories depending on need.

Mr. Rosenberg then reminded participants about the questions he had posed to them the previous day regarding their current status in the budgetary cycle, and the impact/value of these seminars in changing their budgetary practices. Following is a brief summary of the feedback provided by each participating local government representative.

### ***Baja:***

1996 has been a difficult year for this city. They had no new loans, which had affected their budget. The city therefore tried to sell its fixed assets to serve as a cushion or buffer to cover the absence of loans. The city plans to decrease expenditures from 1997, and also plans a rolling budget for the years 1997 - 2001.

### ***Budapest District XIX:***

District XIX has already prepared its budget policy, which will be discussed on November 17. The budget policy is based on the past two years and focuses on the areas of financing, education, welfare and culture. The city has taken on a service focus in their budgeting, by attempting to determine financing percentages for different service areas. Since 1992, District XIX has maintained separate capital and operating expenditure budgets. They experienced some financial difficulty in 1994.

### ***Debrecen:***

The city is currently preparing its budget policy for 1997. The new element in the 1997 budget is that the city is analyzing the budget trends of previous years in the following areas: 1) housing stock; 2) debt balance; 3) city property (sale of city assets, and what the funds have been used on); 4) establishment of normatives in the health and education sectors; 5) revenue estimates of 1996 (financially the city is in a critical situation—grants cover only the salary of employees, therefore other expenditures need to be covered from

other credits); and, 6) credit—the city cannot get new loans due to their financial condition, therefore a deeper analysis of the budget is necessary to examine if bridging loans are possible.

#### **Győr:**

The city had problems with liquidity and a budget deficit in 1994. They have already taken steps to reverse the situation and initiated the small treasury system as in Békescsaba. However, the system in Győr is based on a new electronic network and referred to as ad hoc financing. This was initiated in June 1994. Since then the city has not taken on any new loans.

The 1996 budget is now considered as being ad hoc by the city. An analysis of the last three years data has confirmed this to be a fact. Even though the city is no longer experiencing any liquidity problems, some services have not been presented well in the budget. The city has therefore realized that it needs to impose greater accountability for service provision and also stricter deadlines.

Győr has undertaken a comparison of actual versus estimated revenues since 1992-1993. The conclusion is that the city is better at estimating its own revenues versus central transfers. The revenue possibilities for 1997 have now been outlined based on this past study. Revenue estimates of HUF 2 billion have been forecasted. However, expenditure responsibilities of the city are so many that they cannot all be realized.

Lessons learnt: The city tried zero based budgeting, but did not succeed in achieving this for the operational budget. A housing plan which was created until the year 2000 has also not been followed.

#### **Hajdúszoboszló:**

This was the first seminar being attended by the city. Hajdúszoboszló has a 50 percent budget surplus which it will incorporate into their 1997 budget. They have recently restructured the different organizations in the city and are currently working on establishing the small treasury system.

#### **Orosháza:**

Orosháza is currently in the process of preparing their budget policy. Their main goal is to stop indebtedness. The city is also accessing its property with a focus on housing rehabilitation and renovations.

#### **Pécs:**

The city has already prepared its budget policy which will be passed by the committee on November 7. The changes initiated in their budget are: 1) introduction of program budgeting in the area of welfare, 2) development of financial indicators (the city has initiated data requests from the different institutions, and, 3) forecasting revenues and expenditures for 1997.

***Püspökladány:***

The city plans to use program budgeting in its education sector.

***Szentes:***

Szentes is going to initiate program budgeting in the communal services program from 1997. The sub-programs will be park maintenance and street cleanliness. The city's objective is to start fiscal year 1997 without a budget deficit. In June 1996 they introduced a small treasury system and have chosen their own bank. They are currently collecting data for the purpose of evaluation under their new system of program budgeting.

**A. Training Session I**

Following the brief presentations by representative local government official, Mr. Róbert Kovács (MRI) and Mr. András Vígvári (Hungarian local trainer) made a presentation on forecasting techniques for designing municipal incomes and expenditures. They started with a saying: "Forecasting is similar to driving a car with blindfolded eyes and having someone give us directions who is looking out of the back window." This saying summarizes two important elements of forecasting: 1) its risk and uncertainty; and 2) the fact that forecasting is built upon the past.

The following elements of forecasting were explained by Mr. Kovács and Mr. Vígvári: forecasting functions; types of forecasting (by period of time and by functions); forecasting methods (expert estimation, deterministic estimation, and econometric models); information base for forecasting (external and internal); methodological problems of information handling; and finally, a detailed explanation of the Credit Locale de France (CLF) model of forecasting which has been used by several Hungarian cities. This system has a practical base of grouping different elements of the budget together and developing forecasts of revenues and expenditures.

Following the presentation, local governments were divided into two groups for the practical exercise of practicing the CLF model and doing inflationary adjustments. Based on the data provided, the groups had to make calculations for the CLF model, make inflationary adjustments for total revenues, and prepare a forecast of the aggregate figures of the CLF

table under different assumptions. After completing the exercise the two groups made their presentations.

## **B. Guest Speaker**

The guest speaker at the seminar was Dr. Sándor Varga from the Ministry of Finance. He gave a speech about intergovernmental transfers and budgetary changes at the central government level which would impact the functioning of local governments. Following are a few highlights of his speech. Dr. Varga stated that there would be a 4 percent reduction in staff in the following year, which implies a loss in 20,000 jobs. However, with a reduction in jobs, the wage rate of the remaining staff would increase. There would be a decrease in the real value of central government investment in 1997, even though the nominal value would remain unchanged. Next year would also see an increase in targeted and addressed subsidies to local governments, but share of personal income tax (PIT) allocated to local governments would continue to be 36 percent. However, the criteria of PIT allocation would change. Currently local governments get 25 percent as a outright share and 11 percent on a normative basis. This will change to 22 percent being shared with all local governments and 16 percent being allocated on the basis of normatives.

Dr. Varga also stressed that the three year rolling plan would be mandatory for the 1997 budget, forcing local governments to plan for and consider several years commitments. Mandatory staff planning would also be a new element enforced by the central government. Another objective of the central government was to decrease inflation to 13 percent by 1998, and 10 percent by 1999.

Dr. Varga finally concluded that the new Treasury system would not be in place by 1998, but later,<sup>1</sup> and stated that local governments own revenues would have to account for a greater percent of their total revenues, since the number of normative subsidies could be decreased.

## **C. Training Session II**

The second half of the day dealt with revenue alternatives in a joint presentation by Mr. Philip Rosenberg and Mr. Mihály Lados (Hungarian local trainer). They started by giving a few examples of revenue alternatives faced by local governments: user fees, impact fees (such as betterment fees/contributions) and other local taxes. The participants suggested the following additional examples of revenue alternatives:

- n own revenues
- n interest from investment funds

---

<sup>1</sup> See *Modernizing Financial Management for Hungarian Local Governments, Pilot Year Seminar*. September 12-13, 1996 by yar-Stone for a description of the new treasury system.

- n user fees
- n rents
- n asset yields
- n local duties
- n grants (funds for operational services)

After contrasting the characteristics of taxes and user fees, Mr. Rosenberg and Mr. Lados suggested factors which should be taken into consideration while designing a fee structure. Pricing policies and different types of rates were also discussed.

Following the presentation, participants did an exercise on establishing user fees for a hypothetical city. After hearing the participants analysis, Mr. Rosenberg discussed the correct answers.

#### **D. Background Reading**

The binder handed out to participants included background or additional reading on various topics covered during the two day seminar. These were provided so that participants would have access to more detailed and specific issues related to the topics covered.

#### **E. Local Government Homework**

Since the philosophy of the municipal budgeting program is to have an interactive and hands-on dialogue with local governments, they are required to complete and return some exercises prior to the next seminar. Homework is based largely on material just presented and learned during the seminar, and partly on material which will be covered in the next seminar. The objective is for trainers to have an idea about their understanding and approach to future topics. The homework assignment in this seminar had the following elements: 1) defining programs and sub-programs; 2) developing performance measures for each sub-program; 3) identifying revenue alternatives; 4) forecasting the budget for the next three years; and, 4) providing information on current capital programing and budgeting practices/needs which will be incorporated into the December 1996 seminar.

#### **F. Conclusions**

A post mortem of the two days was held at Hotel Rubin immediately following the conclusion of the seminar. It was attended by the following MRI staff, local Hungarian trainers and Urban Institute staff. From MRI—Mr. József Hegedüs, Ms. Judit Kálmán, Ms. Andrea Tönk\_, and Mr. Róbert Kovács. The Hungarian trainers included Ms. Katalin Pallai, Mr. Mihály Lados and Mr. András Vigvári. The UI staff included Ms. Katharine Mark and Ms. Ritu Nayyar-Stone, and the UI consultants Mr. Philip Rosenberg and Mr. Blue



Wooldridge. The draft agenda for the next seminar on December 5—6, 1996 was drafted, and the trainers and experts gave their feedback on the seminar just concluded. The following conclusions were reached on the basis of the discussion.

n        There was a need for greater feedback and participation from the local government officials so that the seminar could be adapted to their needs. Mr. Rosenberg's insistence that municipal officials give feedback about their current budgetary status at the start of the second day of the seminar, had already provided valuable insight on the budgetary problems and innovations of the different cities. It was necessary to encourage and insist on greater interaction by the different cities.

n        There were too many new topics being covered in each seminar, and participants seemed to be overloaded with information.

n        Seminars were too long and intensive.

Based on the above conclusions, it was decided that the December seminar would focus on only one substantial new area, that is, capital programing and budgeting, and be only a day and a half long. Each city participating in the seminar would have to make a presentation in the December seminar—either giving feedback on an homework assignment, or make a program budget presentation on the sector which would be incorporated as a program in their city's 1997 budget.

**Table 1**  
**List of Cities Participating in the Initial and September Seminar**

No.	Cities	Population	June 27, 1996	September 12-13, 1996	October 30 - 31, 1996
.	Baja	39,800	ü	ü	ü
.	Budapest District VIII	40,042	φ	ü	ü
.	Budapest District XIX	78,400	ü	ü	ü
.	Debrecen	24,900	ü	ü	ü
.	Derecske	9,500	ü	φ	φ
.	Dunavarsány	5,201	φ	ü	φ
.	Eger	61,400	ü	φ	φ
.	Gyor	131,100	φ	ü	ü
.	Hajdúszoboszló	23,387	φ	φ	ü
.	Jászládány	6,100	ü	ü	φ
.	Kistelek	7,900	ü	φ	φ
.	Nagykanizsa	53,353	φ	φ	ü
.	Orosháza	34,600	ü	ü	ü
.	Pécs	167,400	ü	ü	ü
.	Püspökladány	17,000	ü	ü	ü
.	Szentes	33,000	ü	ü	ü
.	Szombathely	85,200	ü	ü	φ
.	Szolnok	81,500	ü	ü	ü
.	Zalaegerszeg	62,485	φ	ü	φ